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Securities Industry Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
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PERSPECTIVES ON THE SMALL REGIONAL FIRMS

Highlights

1. Commissions of the Small Regional firms, their main revenue source, fell 32% in 1988 (based on first half data), or back to levels of three years ago.

2. Last year, Small Regionals' trading profits fell to $36 million, their lowest level since 1982. This year, however, first half results project more than a 50% recovery to an annual $55 million trading profit.

3. Faced with a 20% drop in revenues in 1988, Small Regionals have quickly moved to contain costs, slashing expenses by 23% in 1988. The "net" result: last year's $14 million loss for this group is projected to be reversed to a $3 million pre-tax profit.

4. Despite commendable cost cutting by the Small Regionals, this year's 0.7% profit margin is the worst showing, sans last year's loss, for this group during the Eighties and the lowest of all firm groups except the National Full Line firms.

5. The gross production of retail RRs at regional firms with fewer than 50 RRs fell 28% after October's crash, as did these firm's retail RR earnings. This resulted in a 29% drop in net production, a steeper drop than the 18% felt by all firms.

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Introduction

This year, the securities industry has often been characterized as a tough, marginally profitable (if at all) business to be in, especially for the highly retail oriented firm. Terms such as anemic, worsening, pare-backs, etc., have proliferated in press descriptions of securities markets and firms. In a snapshot view of today's markets, as most readers of this issue of Trends are painfully aware, these are apt descriptions. But if one word describes the securities industry best, it's volatile. A videotape of the long haul, however, would show various industry areas traveling differing paths -- some on Everest climbs, others on bobsled runs and still others, such as profits, on a continuous roller coaster ride (but riding the downslope in recent periods).

There have been many forces over the past few decades which have affected, and continue to change, the nature and fortunes of the securities industry. Prominent among these have been deregulation, competition, globalization, product proliferation, institutionalization, etc.

One of the most striking changes in the industry has been the basic shift in revenue sources over time. Prior to the deregulation of commission rates in 1975, the securities business was almost entirely an agency equity commission driven business. As long as there was volume, the industry enjoyed a nice, safe income stream -- protected from the risks of volatility from principal businesses. And prior to May Day 1975, this business line was also protected from price competition. Although some firms, including many regional firms, have continued to concentrate on this business, for the industry as a whole this scenario has changed radically.

Bread & Butter Businesses

For the total securities industry, which includes all firms, investment banks as well as regional firms, commissions have gone from over three-fifths of industry revenues in 1965, to less than one-fifth in 1988 (Table 1). Meanwhile, the principal businesses today are the bread and butter source for the securities industry as a whole. Trading and investment profits, principally debt trading, have risen from less than 10% of 1965 industry revenues to over one-quarter during the past few years. This excludes underwriting profits, which have consistently generated around 10% of revenues (although becoming a more and more concentrated activity among firms), and other investment banking activities such as M&A and private placements. Profit margins, discussed later, also have lessened over the years. Table 1 illustrates how the main components of revenue have shifted in importance over time.

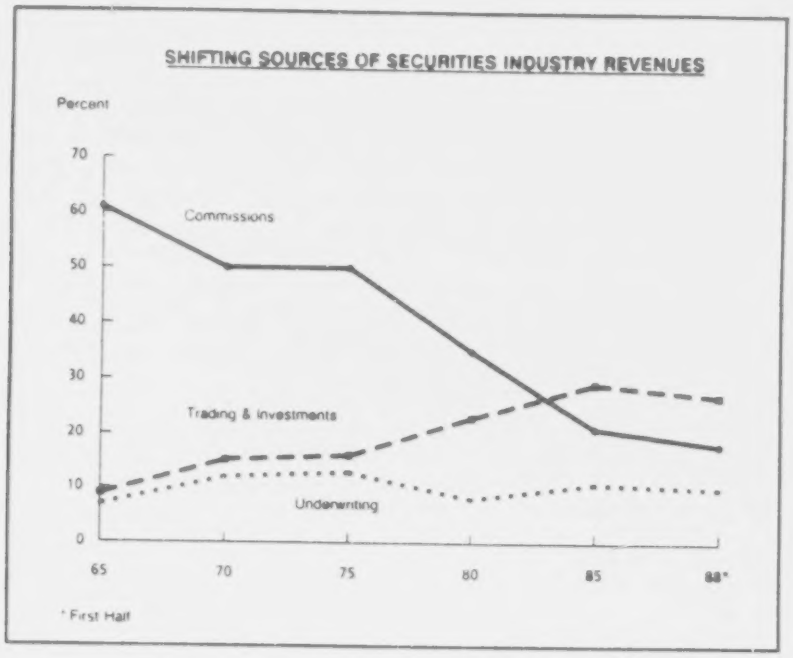
Table 1

SHARE OF SECURITIES INDUSTRY REVENUES

(Percent of Total Revenues)

	1965	1970	1975	1980	1985	1988
Commissions	60.9	49.8	49.9	35.4	21.3	18.3
Trading and Investments	8.8	15.1	15.6	23.1	28.5	26.8
Underwriting	7.2	11.9	13.3	8.3	11.0	10.0
Other Revenues	23.1	23.2	21.2	33.2	39.2	44.9
Profits	0.4	14.9	13.6	14.1	10.7	6.7

Note: Based on all NYSE member firms doing a public business; 1988 data based on first half.



The downward trend does not mean that there has been an actual drop in commission dollars, only that their relative importance has decreased. Industry commissions have actually increased year to year. They grew from just $1 billion in 1965 to around $9 billion this year (based on six-month figures).

Trading profits and investment gains, meanwhile, grew from $200 million in 1965 to a projected $13.7 billion this year. Underwriting, which holds pretty steady as a percent of total revenues over the decades, grew from about $170 million in 1965 to a projected $5.1 billion this year (Table 2).

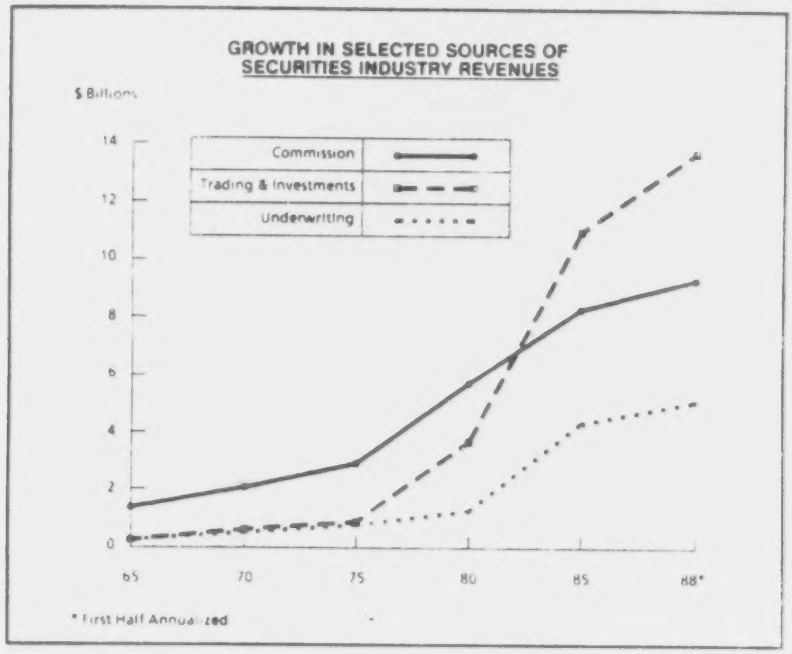
Table 2

GROWTH IN SELECTED SOURCES OF REVENUES

(In $ Billions)

	1965	1970	1975	1980	1985	1988
Commissions	1.4	2.1	2.9	5.7	8.3	9.3
Trading and Investments	0.2	0.6	0.9	3.7	11.0	13.7
Underwriting	0.2	0.5	0.8	1.3	4.3	5.1

Note: Based on all NYSE member firms doing a public business; 1988 data based on first half.



The long-term trend in Table 2 does not show the volatility in intervening years and quarters, however. For instance, commissions went from $8.3 billion in 1985 to a projected $9.3 billion this year. That's an upward trend. However, it already hit $9.3 billion in 1986, shot up to $12.6 billion last year and fell back to 1986 levels this year!

Trading and investment revenues rose from $11 billion in 1985 to a projected $13.7 billion this year. But they were likewise volatile. This year's figure, just like commissions, was already attained in 1986.

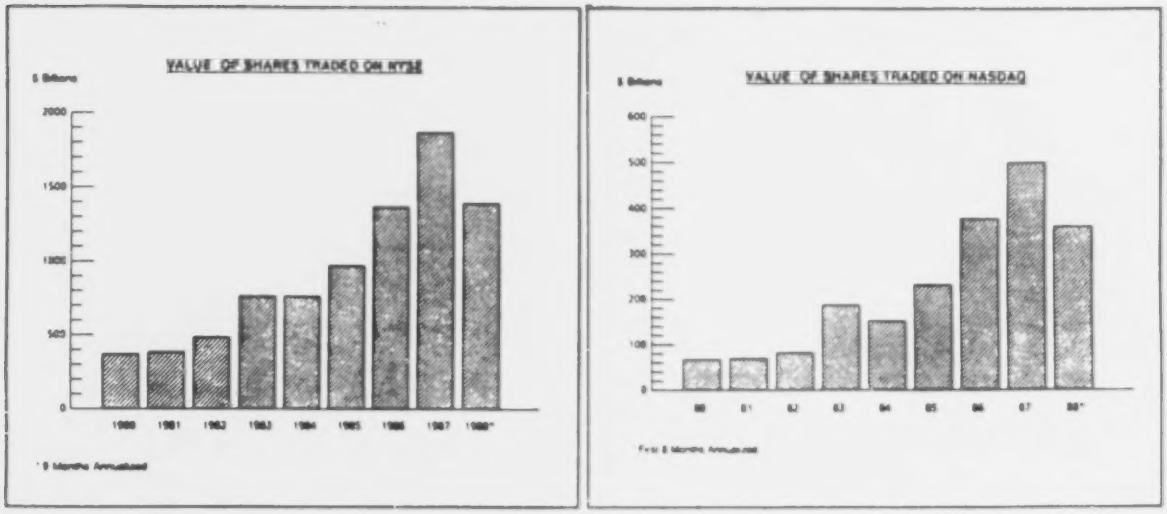
So, again, the long-term trend is up but in any given year you can toss a coin to project if next year's trend is going to be up or down relative to the previous year.

Underlying Equities

The growth in commission dollars has been sparked by incredible growth in volume or, more importantly, the value of equity trading, particularly during the Eighties. Table 3 shows the growth in the dollar value of trading on the NYSE and NASDAQ during the Eighties.

Table 3

VALUE OF EQUITY TRADING



Increased Institutionalization

Besides the price competition which has, in part, contributed to the decline in commissions' relative importance, demographics have also altered the commission picture, tipping the scale more and more toward the institutional side. Table 4 shows how the holdings of U.S. equities, once almost entirely held within the household sector, has shifted to a three-fifths/two-fifths split between households and institutions, and illustrates how these two sectors are converging.

Add to this altered holdings picture the increased dominance of institutions in the marketplace itself -- NYSE volume is now 75% institutional (SIA's Investor Activity Report) with the options and futures businesses almost entirely institutional -- and it's evident that retail firms are left with an ever shrinking segment of the equities business, historically the main fuel of the retail business.

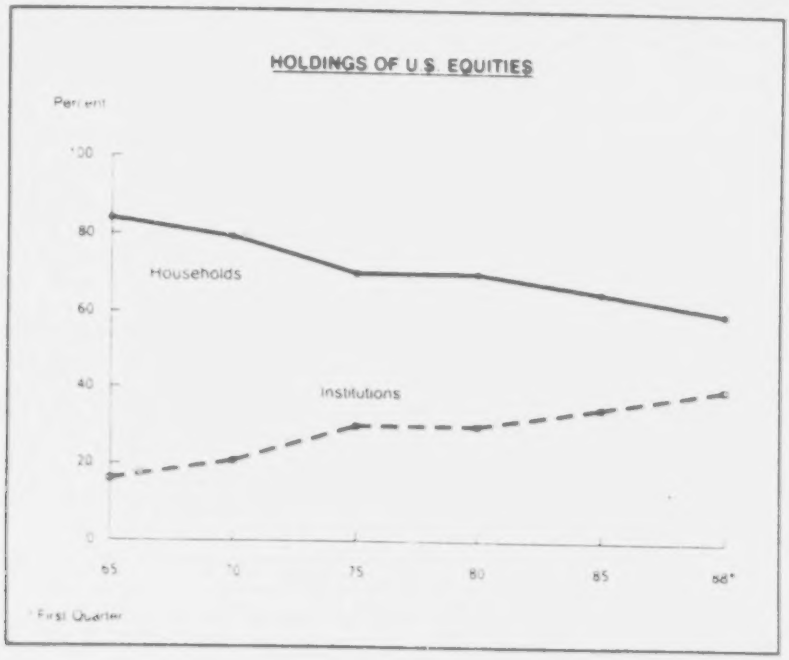
Table 4

HOLDINGS OF U.S. CORPORATE EQUITIES

(In Percent)

	1965	1970	1975	1980	1985	1988
Households	84.1	79.3	70.4	70.2	65.3	60.0
Institutions	15.9	20.7	29.6	29.8	34.7	40.0
			(In $ Trillions)			
Households	0.6	0.7	0.6	1.1	1.7	1.8
Institutions	0.1	0.2	0.3	0.5	0.9	1.3

Note: Based on Federal Reserve Board's Flow of Funds data, excluding mutual funds. Figures are at market value, and 1988 data as of March 31.



Securities Industry Concentration

Another change affecting the industry, particularly smaller firms, is the increased concentration of the securities business in the hands of the larger firms. For the NYSE member firms which deal with the public (generally 400 of the industry's largest firms), the 10 largest capitalized firms (2.5% of the firms) generate 55% of the industry's revenues and control 60% of the industry's capital. Another 21% of the revenue and 17% of the capital is in the hands of the next 15-largest firms (4% of the firms), leaving less than a quarter of total revenues and capital for the remaining 350 to 375 (93%) NYSE firms.

How Have Smaller Firms Fared?

The question arises, if the industry financials are so weighted by the largest firms, what's been happening to the smaller firms? In past issues of Trends, sub-categories of the NYSE group were analyzed, i.e., National Full Line firms, Large Investment Banks, Regionals, Discounters, New York City-based regionals, etc. But the Regionals' group can also be sub-divided into Large, Medium and Small Regionals. To see how the smaller firms are faring, we will analyze this group of Small Regionals (see Appendix for a list of these firms).

These Small Regionals have revenues ranging from $2 million to $20 million, averaging around $10 million; have total capital averaging around $4 to $5 million and employ around 100 people each; clearly larger than many small firms, but their business mix is still typical of most small firms. For example, their business is mainly commission income, and their performance does reflect the same trends and forces affecting most small firms.

As Table 5 shows, the growth in revenues and expenses for Small Regional firms during the Eighties, at least through last year, has been strong. On an aggregate basis, most revenues and expenses showed a near linear growth from 1980 through the 1986-87 period, with the exception of 1984, a poor year for the securities industry. Over this period, total revenues were up over 60%, although falling about 20%, this year.

Expenses, unfortunately, grew much faster than revenues. Total expenses doubled from 1980 through last year. Compensation, the biggest expense item, also doubled. This year, based on first half results, cost control measures have reduced all expenses 23%, and compensation costs, 24%.

Trends in Revenue Sources

Commissions, the Small Regionals' main revenue source, is down a drastic 32% so far this year, matching 1985's level. We've previously seen how commissions have fallen to just 18% of total revenues for all NYSE firms. For Small Regionals, commissions were still half of all revenues in 1980 and 1987, but have ranged from just 40% to 45% of all revenues for most of the Eighties (Table 6).

Trading revenues, mainly from OTC market making and bond trading, will exceed last year's showing which was running below 1986's level even before the crash-impacted fourth quarter caused an additional $6 million loss.

Revenues from investments in firms' own accounts are running slightly ahead of last year but below the 1986 level. Underwriting revenues, meanwhile, increased during the bull equity years of the Eighties, but have now fallen back to the same aggregate levels before Rule 415's passage by the SEC. Further, margin interest revenues peaked for the Small Regionals in 1981, and have been gradually declining to an annualized low of $23 million this year. Conversely, interest expense also peaked in 1981 and declined to an annualized near-low of $29 million this year.

Revenues from the sale of mutual funds rose over 12-fold over the five years, 1981 to 1986, practically doubling each year, to a record $62 million (or 13% of revenues). This income source has now fallen to less than $22 million (on an annualized basis), back to 1984 levels or just one-third of their amount two years ago.

Table 5

NYSE SMALL REGIONALS' FINANCIALS

(In $ Millions)

Revenues	80	81	82	83	84	85	86	87	88*
Commissions	155.4	145.5	149.5	192.8	146.1	164.7	206.2	241.9	164.8
Trading	33.6	31.9	35.1	41.5	43.9	67.2	62.4	35.6	54.6
Investments	4.9	0.1	1.4	4.5	1.4	6.0	9.2	8.1	8.6
Underwriting	22.0	27.8	29.1	46.2	33.3	44.0	38.4	29.2	25.4
Margin Interest	41.1	63.7	47.0	41.1	42.7	32.1	28.0	27.0	23.2
Mutual Funds	4.5	5.4	9.6	16.5	18.9	33.5	61.9	48.0	21.8
Fees	9.6	10.5	11.5	13.3	15.4	20.1	23.5	23.8	24.6
Research	1.6	0.7	0.6	1.3	3.4	4.3	4.5	7.8	9.6
Commodities	1.4	0.9	0.9	1.1	0.9	1.1	3.5	3.6	4.0
Other Related	19.7	29.2	31.9	29.9	29.5	33.8	39.1	41.5	36.2
Other	5.4	7.3	6.9	7.0	10.0	8.6	12.0	18.8	13.8
Total Revenues	299.4	323.2	323.7	395.0	345.5	415.6	489.0	485.4	387.0
Expenses									
Compensation	147.2	126.6	163.5	210.3	185.4	222.0	270.7	290.2	221.0
Floor Costs	20.1	18.6	18.1	20.3	17.6	21.6	26.7	31.1	23.2
Communications	16.4	37.0	20.8	24.3	23.7	23.8	28.6	31.4	27.4
Occupancy/Equp.	11.0	29.2	14.5	17.6	19.7	20.3	25.7	27.5	26.4
Promotional	8.7	11.2	12.1	14.4	14.1	14.4	15.3	13.7	9.8
Interest	30.6	49.6	39.3	31.0	34.3	26.4	26.7	34.8	29.0
Error/Bad Debt	1.8	1.1	1.8	2.6	1.1	1.0	2.9	11.0	1.0
EDP Costs	5.2	6.2	6.4	7.6	7.6	8.3	10.2	12.0	11.2
Non-Recurring	1.6	1.0	1.3	1.4	0.3	0.9	0.5	0.3	0.2
Regulatory Fees	2.4	2.6	2.5	3.2	3.3	4.0	3.7	3.7	3.4
Other Expenses	13.9	15.6	16.8	21.8	21.4	25.5	37.7	44.0	31.0
Total Expenses	259.0	296.1	296.5	354.8	328.4	368.8	447.9	499.5	384.2
Net Income	40.4	27.1	27.2	40.2	17.1	46.8	41.1	(14.1)	2.8

*First half annualized.

Table 6

NYSE SMALL REGIONALS' FINANCIALS

(Percent of Revenues)

Revenues	80	81	82	83	84	85	86	87	88*
Commissions	51.9	45.0	46.2	48.8	42.3	39.6	42.2	49.8	42.6
Trading	11.2	9.9	10.8	10.5	12.7	16.2	12.8	7.3	14.1
Investments	1.6	0.0	0.4	1.1	0.4	1.4	1.9	1.7	2.2
Underwriting	7.3	8.6	9.0	11.7	9.6	10.6	7.9	6.0	6.6
Margin Interest	13.7	19.7	14.5	10.4	12.4	7.7	5.7	5.6	6.0
Mutual Funds	1.5	1.7	3.0	4.2	5.5	8.1	12.7	9.9	5.6
Fees	3.2	3.2	3.6	3.4	4.5	4.8	4.8	4.9	6.4
Research	0.5	0.2	0.2	0.3	1.0	1.0	0.9	1.6	2.5
Commodities	0.5	0.3	0.3	0.3	0.3	0.3	0.7	0.7	1.0
Other Related	6.6	9.0	9.9	7.6	8.5	8.1	8.0	8.5	9.4
Other	1.8	2.3	2.1	1.8	2.9	2.1	2.5	3.9	3.6
Total Revenues	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Expenses									
Compensation	49.2	39.2	50.5	53.2	53.7	53.4	55.4	59.8	57.1
Floor Costs	6.7	5.8	5.6	5.1	5.1	5.2	5.5	6.4	6.0
Communications	5.5	11.4	6.4	6.2	6.9	5.7	5.8	6.5	7.1
Occupancy Equp.	3.7	9.0	4.5	4.5	5.7	4.9	5.3	5.7	6.8
Promotional	2.9	3.5	3.7	3.6	4.1	3.5	3.1	2.8	2.5
Interest	10.2	15.3	12.1	7.8	9.9	6.4	5.5	7.2	7.5
Error Bad Debt	0.6	0.3	0.6	0.7	0.3	0.2	0.6	2.3	0.3
EDP Costs	1.7	1.9	2.0	1.9	2.2	2.0	2.1	2.5	2.9
Non-Recurring	0.5	0.3	0.4	0.4	0.1	0.2	0.1	0.1	0.1
Regulatory Fees	0.8	0.8	0.8	0.8	1.0	1.0	0.8	0.8	0.9
Other Expenses	4.6	4.8	5.2	5.5	6.2	6.1	7.7	9.1	8.0
Total Expenses	86.5	91.6	91.6	89.8	95.1	88.7	91.6	102.9	99.3
Net Income	13.5	8.4	8.4	10.2	4.9	11.3	8.4	(2.9)	0.7

*First half

Fees from account supervision mirrored the climb of mutual fund revenues as they reflect the amount of assets gathered in-house, partly from the sale of these packaged products. However, once these assets are being managed in-house they become more "crash resistant" in that they continue to generate management fees as long as there isn't a large net sell-off of the aggregate portfolios under management (or large net transfer out from management by these groups of firms). In fact, the fee income of around $24 million from this sector this year will match 1986 and 1987 levels. Moreover, it is now a larger contributor to total revenues than ever before (6.4%).

Compensation Costs -- Expense #1

Compensation expense doubled for the Small Regionals from 1980 through last year, outstripping these firms' revenue growth. At the beginning of the Eighties, just under half of all revenues went towards compensation but payroll costs, as mentioned, kept eating further and further into the revenue base. It steadily climbed to 60% of revenues last year and although absolute compensation expense has fallen 24% this year, it still is consuming over 57% of this year's much smaller revenue base.

This growth in compensation is mainly in the clerical area. Registered representative compensation, while growing over the years, has held even at just under a quarter of all revenues. Clerical compensation, however doubled from 1980 through 1987 and inched up as a proportion of total revenues, now 18%, second only to RR compensation's 23%.

Total expenses doubled from 1980 through last year to a record $500 million for the Small Regionals but fell 23% so far this year. As for the pre-tax bottom line, the best profit margin achieved in the Eighties was 13.5% way back in 1980. In the very good bull years of 1983 and 1985, this group managed only a 10% to 11% return and in 1981, 1982 and 1986, also good years, the margin was only 8.4%. Last year, a tough time for all types of firms in the securities industry, these firms lost money but they have managed to climb back into the black in 1988's first half.

What About Profits?

How does this group of small firms compare with other NYSE groups when it comes to profitability? Table 7 highlights the profit margins over the Eighties for all NYSE firms and other sub-categories, including Medium, Large and all Regionals. In almost every case, the Small Regionals underperformed their larger regional counterparts as well as every other firm category except the National Full Line Firms.

Table 7

PRE-TAX PROFIT MARGINS

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88*
National Full Line	10.9	6.9	8.8	8.6	(0.9)	5.6	6.9	(0.9)	0.3
Large Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6	13.5	4.7	10.4
New York City Based	14.8	12.6	14.0	18.3	8.9	12.3	16.1	2.2	11.5
NYSE Discounters	17.5	12.2	13.6	14.0	0.3	8.9	15.7	8.6	3.4
Regionals	14.7	11.2	11.1	12.6	2.6	9.4	11.0	5.5	3.4
Large Regionals	15.6	11.7	10.6	12.5	1.8	7.6	11.9	7.2	4.9
Medium Regionals	13.6	11.1	13.0	13.5	3.1	11.6	10.0	4.7	1.1
Small Regionals	**13.5**	**8.4**	**8.4**	**10.2**	**4.9**	**11.3**	**8.4**	**(2.9)**	**0.7**
Total Industry	14.1	10.8	13.1	12.9	5.2	10.7	11.0	2.3	6.7

*First Half.

The previous analysis highlights some basic shifts in the relative importance of certain income sources and expenses over nearly a decade. But the most dramatic changes began last year.

Moving from Bull to Bear

Last year, the Small Regionals had only one profitable quarter as a group. This, not surprisingly was in the first quarter while the bull was still roaring. So far this year, these firms have not been able to collectively earn anywhere near $1 million per quarter nor muster even a 1% profit margin before taxes! Table 8 shows what has happened to some key financials of Small Regionals since the first quarter of last year. Revenues were $140 million and fell to around $125 million in the second and third quarters or down more than 10%. In the fourth quarter and in each of this year's first two quarters, revenues fell to levels just below $100 million, or down another 20%.

Commissions fell from around $65 million in each of 1987's first two quarters to $58 million in the last two, or down more than 10%. This year's first two quarters showed commissions of only $41 million.

Cost Cutting -- a Survival Instinct

Though the previous figures indicate very bleak times for smaller firms, it also shows that these firms have been able to quickly adapt their cost structures to survive in these tough times. On the anemic level of revenues this year, which are even worse than the crash-impacted fourth quarter last year, these firms did manage to contain expenses, especially the all important compensation line, so that their bottom line is again being penned in black ink. These reductions were not unpainful -- in 12 months, Small Regionals reduced their workforce by 24% or a loss of nearly 1,200 jobs.

Table 8

SMALL REGIONALS' QUARTERLY PERFORMANCE

(In $ Millions)

	87:Q1	87:Q2	87:Q3	87:Q4	88:Q1	88:Q2
Revenues	138.5	125.5	122.0	99.4	98.5	95.0
Commissions	62.5	63.6	58.8	57.0	40.7	41.7
Expenses	129.5	127.9	122.1	119.8	97.7	94.4
Compensation	79.0	76.9	71.3	63.0	56.4	54.1
RR Comp.	31.4	32.4	29.3	25.4	24.6	19.8
Clerical	21.7	22.4	22.5	19.7	16.9	17.1
Profits	8.9	(2.5)	(0.1)	(20.4)	0.8	0.6

Employment

	87:Q1	87:Q2	87:Q3	87:Q4	88:Q1	88:Q2
Producers	2,071	2,214	2,101	2,057	1,910	1,577
Non-Producer	2,645	2,593	2,697	2,252	2,127	2,079
Total	4,716	4,807	4,798	4,309	4,037	3,656

Retail RR Production and Earnings

For small firms, financial health is very dependent on how retail RR production is doing. Unfortunately, here again, the post-crash scenario has been gloomy. According to one of many compensation studies produced by SIA, Report on Production and Earnings of RRs, the growth of gross production of retail RRs throughout the Eighties for all firms, including small firms, was extremely strong through 1986 (also true for institutional RRs). However, production leveled off last year, not in small part due to the final quarter's market crash.

A follow-up survey for the post-crash environment (November 1987 through April 1988, annualized), shows that retail production turned on a dime (Table 9), cascading to levels not seen for years.

For this survey's small firms (those with fewer than 50 retail RRs), gross production of retail RRs rose $15,000 in 1986 and another $20,000 last year, to a 1987 average of $199,000. However, in the six months since the crash, this production was down 28%, or more than $56,000 to a level of just $142,000 on an annualized basis (Table 9). This was a much steeper drop than the National firms or the industry average.

Comparing gross production to the average earnings of retail RRs for all firms, we see that the drop of about $56,000 per RR in production equally ate into the pockets of the RRs and the firm to the tune of about $28,000 each. However, a similar drop of $57,000 in small firms' retail production was not equally shared by the producer and the firm. The small firms' producer saw his earnings fall $22,000 while the firms' net production dropped $34,000.

Table 9

AVERAGE RETAIL RR PRODUCTION

(In $ Thousands)

	1985	1986	1987	11/87 4/88*	% Change 87-88
Large National Firms	214.1	250.9	258.1	197.0	(23.7)
Small - Up to 50 RRs	165.5	179.9	199.0	142.4	(28.4)
All Firms	206.0	243.8	246.5	190.8	(22.6)

AVERAGE RETAIL RR EARNINGS

	1985	1986	1987	11/87 4/88*	% Change 87-88
Large National Firms	81.8	99.4	97.4	67.1	(31.1)
Small - Up to 50 RRs	69.3	82.5	78.8	56.6	(28.2)
All Firms	79.6	97.1	94.0	66.2	(29.6)

AVERAGE NET RETAIL INCOME

	1985	1986	1987	11/87 4/88*	% Change 87-88
Large National Firms	132.2	151.5	160.7	129.9	(19.2)
Small - Up to 50 RRs	96.2	97.4	120.2	85.8	(28.6)
All Firms	126.4	146.7	152.5	124.6	(18.3)

*Annualized

Source: SIA's "Report on Production & Earnings of RRs"

However, on a percentage basis, the reverse is true. Small firms' retail RR's gross production, earnings and the firm's net production all fell an equal 28%. Meanwhile, for all firms, the retail RR's production fell 23%, his earnings fell a larger 30%, leaving the firm with a net production falling a smaller 18%.

Surviving in a Down Market

What else is needed to survive these periods? We've seen that the assets which were gathered in-house during the bull market, despite anemic additions on top of attritions since the crash, are still generating fee income, projected to reach a record $25 million for Small Regionals this year. Further emphasis on fee income and asset gathering is a must for such firms.

Small Regionals have also been able to maintain over $20 million in OTC market making profits since 1985 -- double the levels of the early Eighties. Since many of the major New York houses, as well as other brokerages, having curtailed their inventories of these securities as well as the spectrum of stocks they once covered since the crash, small firms' specialty and regional coverage in this area also provides opportunities to continue, if not grow, this part of the business.

Bond trading for Small Regionals this year accounts for double the share of revenues it did at the start of the Eighties. While this year's profits from debt trading is expected to fall short of 1985's record level, it still should be emphasized as a profit center especially with today's individual investor's appetite for safe fixed-income products.

In the same vein, mutual fund products, while horrendously off on the equity side, have become such a large contributor to the total revenue picture (and the fee picture also) in recent years that emphasizing the fixed-income products available is a must to keep this revenue source alive in these markets.

Underwriting revenues tie into this same picture. On the debt side, underwritten CDs have been a growing item in this market and the fixed-income closed end funds have been the one equity product hit of 1988. Over three-quarters of the $17.4 billion in IPOs underwritten in this year's first eight months came from these closed end funds. In fact, the $13.3 billion underwritten through August already far exceeds last year's record $9.8 billion. Further, these funds didn't even come alive until 1985 and then shot from nowhere to over $4 billion in 1986, so they are still very young in the product life cycle.

Municipal underwritings, after falling more than 25% annually since tax reform changes took place at the end of 1985, appear to be holding steady at last year's pace. With investors' new-found, or at least only remaining, love for fixed-income products this year, munis appear another revenue hope for small firms.

As far as the bread and butter business line of small firms -- agency equity commissions -- the very real problems this year have been felt before. As we've seen earlier, the drop-offs in volume and business on the exchanges are still only back to pre-1987 levels, a good base to start with for future growth. And in the securities business, ever cyclical, there is always future growth...it's just a question of the timing.

It is this timing which is the big question. So far this year, the value of trading on the NYSE is down a dramatic 26% (SIA's Investor Activity Report). With similar declines in other markets, including the OTC market, and other business lines for the past 12 months, many smaller firms have been financially hurt, and some forced to merge or close shop.

The vast majority, however, have quickly moved to reduce costs to levels more in line with reduced revenues. If the slowdown is not too protracted, small firms' continued cost control measures can position them well for the inevitable up cycle.

George R. Monahan
Director of Industry Studies

APPENDIX

NYSE Member Small Regional Firms*

Adams, Harkness & Hill, Inc.
Baker, Watts & Co.
Bartlett & Co.
Branch, Cabell & Co.
Butler, Wick & Co., Inc.
Cable, Howse & Ragen
Christopher (B.C.) Securities Co.
Davenport & Co. of Virginia, Inc.
Equitable Securities Corporation
Ferris & Company Incorporated
Folger Nolan Fleming Douglas, Inc.
Gradison & Company Incorporated
Hanifen, Imhoff, Inc.
Hazlett, Burt & Watson
Howe, Barnes & Johnson, Inc.
Hummer (Wayne) & Co.
Illinois Company Incorporated (The)
Investment Corp. of Virginia
JW Charles-Bush Securities, Inc.
Midland Doherty & Inc.
Milwaukee Company (The)
Noyes (David A.) & Company
Parker/Hunter Incorporated
Reaves (W.H.) & Co., Inc.
Roulston Research Corp.
Rowland (R.) & Co., Incorporated
Seidler AMDEC Securities, Inc.
Smith, Hague & Co., Inc.
Smith, Moore & Co.
Sterne, Agee & Leach, Inc.
Swift (Henry F.) & Co.
Weber, Hall, Sale & Associates, Inc.
Wilshire Associates
Young, Smith & Peacock, Inc.

*As of June 30, 1988.

PRICES
(END OF MONTH)

	OCT 1988	OCT 1987	% CHAN OCT 1988-1987
DOW JONES INDUSTRIALS	2148.65	1993.53	7.78%
STANDARD & POOR'S 500	278.97	251.79	10.79%
NYSE COMPOSITE	156.94	140.80	11.46%
AMEX MARKET VALUE INDEX	300.95	260.36	15.59%
VALUE LINE COMPOSITE	234.41	201.10	16.56%
NASDAQ COMPOSITE	382.46	323.30	18.30%

(MONTHLY AVERAGES)

	JUL 1988	JUL 1987	BASIS POINT CHG 1988-1987
BOND BUYER INDEX (20 BOND)	7.76%	7.72%	4
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.96	9.42	54
Baa CORPORATE	11.11	10.61	50
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.89	1

VOLUME

	SEPT 1988	YTD 1988	SEPT 1987	YTD 1987	% CHGN YTD 1988 1987
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	145.7	167.3	177.3	181.1	-7.6%
AMEX (MILS.)*	8.4	10.1	12.4	13.7	-26.2%
NASDAQ (MILS.)*	111.8	125.1	148.3	149.9	-16.6%
REGIONAL EXCHANGE (MILS.)*	21.5	23.1	25.6	27.5	-15.9%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$101,435	$1,044,356	$163,895	$1,426,618	-26.8%
AMEX (MILS.)	2,463	25,321	4,222	40,585	-37.6%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,759	64,282	9,481	96,452	-33.4%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	14,805	133,588	15,465	137,856	-15.4%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	54.7%	53.0%	49.8%	51.3%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	8,841	81,063	17,784	146,633	-44.7%
AMEX OPTIONS	3,354	28,059	4,733	41,165	-31.8%
COMMODITY	20,185	184,477	22,407	171,520	7.6%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

UNDERWRITING

	OCTOBER 1988	OCTOBER 1987	% Change 1988-1987
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$21,465.8	$15,131.0	41.9%
Common Stock	$1,619.1	$703.7	130.1%
# of Common Stock Issues	30	55	-45.5%
Preferred Stock	$727.5	$173.9	318.3%
# of Preferred Stock Issues	10	2	400.0%
Corporate Debt	$19,119.3	$14,253.4	34.1%
# of Corporate Debt Issues	213	142	50.0%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$7,619.7	$5,445.2	39.9%
# of Issues	123	175	-29.7%
Competitive	$2,864.3	$2,053.4	39.5%
# of Issues	116	80	45.0%

Source: IDD Information Services

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
"The Debt Binge"	A series of articles pulled together into a Special Report on debt financing. Concludes: U. S. Corporations are operating with more debt and a higher level of risk than at any time in recent memory. This can bring lavish economic rewards, but it can also end in disaster. The need for government and business to work together has never been greater. Business depends on government for sound economic policies, and government depends on business to compete effectively worldwide.	Business Week 11/7/88
"Sources of IRA Saving"	This paper, which reviews the period 1982-86, shows that there is strong evidence that IRA saving does represent new savings. In addition, evidence is provided that even those taxpayers who did enroll in IRAs did not take full advantage of its provisions. This result highlights the role of public information in affecting savings behavior. Thirdly, the paper shows that IRAs were not particularly progressive and suggest that for income levels of less than $40,000, a general saving incentive for interest and dividend income might have been more equitable. However, authors point out that 1) it is not clear that a general saving incentive system would have been as successful as an IRA in encouraging new savings and 2) taxpayers need immediate gratification to nudge them toward adequate retirement saving.	D. Feenberg and J. Skinner National Bureau of Economic Research 10/88
"Foreign Banks Expand U. S. Base"	Exploiting the keen interest in cross-border mergers and acquisition, foreign merchant banks and boutiques are giving U. S. investment banks and boutiques a run for the globally attuned corporate client's money and loyalty. Article also profiles several foreign merchant banks and their strategies.	Pensions & Investment Age 11/14/88

Item	Description	Source
"Fannie Mae Flexes its Muscles"	After almost sinking in the early 1980's under the weight of mismatched debt and investments and a wave of defaults in home-loan markets in certain states, Fannie Mae at age 50 is now on a steady course with $103 billion of assets and a revenue stream of $263 million. Article reviews turbulence of the early 1980s, steps to regain health and plans for the future for this 100% publicly owned company which, in effect, is responsible for the financing of the homes of some 8 million Americans.	Institutional Investor November 1988
"Yes, you can Manage Long Term"	Executives complain that Wall Street won't let them look past the here and now. Article disputes this argument by looking at several companies, their managers, and strategies that have found favor with investors. Conclusion: The stock market tends to get values right and evaluate managers for what they are worth.	Fortune 11/21/88
"Repackaging Junk"	Using "securitization," Street firms have devised a way to turn junk bonds into high grade bonds. Although only a few deals have been put together, industry officials think the potential market is huge -- $30-$50 billion in size by the mid-1990s. Article reviews pros and cons of securitizing junk bonds.	Investment Dealers' Digest 11/28/88
"What Ails Stock?"	What has spooked investors all over the world? Editorial comment briefly reviews experience since the crash and concludes that we're in for a prolonged period of adjustment--in people's attitudes, public policies and perhaps more than anything, in relative investment values.	Barron's 11/21/88